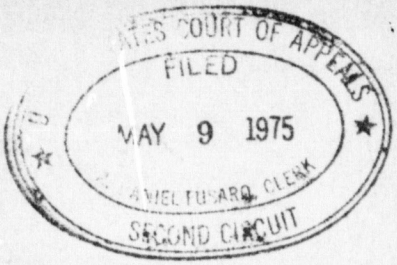
United States Court of Appeals

for the Second Circuit

BRIEF FOR APPELLEE

ORIGINAL

74-2614
74-2657
75-7010



United States Court of Appeals

FOR THE SECOND CIRCUIT

SECURITIES AND EXCHANGE COMMISSION,
Plaintiff-Appellant,

against

GEON INDUSTRIES, INC., et al.,
GEON INDUSTRIES, INC. and
GEORGE O. NEUWIRTH,
Defendants-Appellants,

FRANK BLOOM and EDWARDS & HANLY,
Defendants-Appellees.

On Appeal from the United States District Court for the Southern District of New York

BRIEF OF DEFENDANT-APPELLEE FRANK BLOOM AND DEFENDANTS-APPELLANTS GEON INDUSTRIES, INC. AND GEORGE O. NEUWIRTH

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Preliminary Statement

On October 21, 1974 the United States District Court for the Southern District of New York entered judgment (1) enjoining defendant George O. Neuwirth ("Neuwirth") from further violations of Section 10(b) of the Securities Exchange Act of 1934 (hereinafter sometimes referred to as "the 1934 Act") and Rule 10b-5 promulgated thereunder, (2) enjoining defendant Geon Industries, Inc. ("Geon") from further violations of that statute and rule, and (3) dismissing the complaint of the Securities and Exchange

Commission ("SEC") as to defendants Frank Bloom ("Bloom") and Edwards & Hanly.

This brief is submitted:

a. On behalf of appellee Bloom, in answer to the brief of the SEC;

b. on behalf of appellant Neuwirth;

c. on behalf of appellant Geon.

Issues Presented for Review

A. With Respect To The SEC's Appeal From The Dismissal Of The Complaint As To Bloom

Has the SEC, in asserting that the facts as to Bloom are different than those found by the District Court, demonstrated that the District Court's findings of fact as to Bloom are clearly erroneous?

B. With Respect To The Appeal Of Defendant Neuwirth

1. Did the District Court err in finding that Neuwirth communicated material non-public information concerning Geon to Marvin Rauch, where there was no evidence of such a communication?

2. Did the District Court err in holding that Roy Alpert's ("Alpert") purchases of Geon stock in October, 1973 were effected while he was in possession of material non-public information concerning Geon conveyed to him by Neuwirth?

3. Did the District Court err in holding that Alpert's purchases of Geon Stock on or about December 19, 1973 were effected while he was in possession of material non-public information concerning Geon conveyed to him by Neuwirth?

4. Did the District Court err in holding that Alpert's sales of Geon stock on February 22, 1974 were effected while he was in possession of material non-public information concerning Geon conveyed to him by Neuwirth?

C. With Respect To The Appeal Of Defendant Geon

If this Court reverses the District Court's determination that Neuwirth provided material non-public information concerning Geon to Rauch, is it not also required to reverse the determination that Geon is liable under Rule 10b-5, irrespective of whether it reverses the District Court's determination that Neuwirth provided material non-public information to Alpert?

Statement of The Case

The Facts

Geon's principal business is the importation and distribution of foreign car replacement parts (II 17-18).* Additionally, Geon exports automotive and aviation replacement parts (II 18).

In July, 1973 a representative of Drexel, Burnham & Co., Inc. ("Drexel, Burnham"), an investment banking and brokerage firm, called Peter Neuwirth,** Geon's president, who was then in California (II 20). This call resulted in a meeting at Drexel, Burnham's New York office in August, 1973 which was attended by Bloom, George Neuwirth, Peter Neuwirth, one or two representatives of Drexel, Burnham, Max Roberts, president of Burmah Oil, U.S.A., Campbell Anderson, Burmah's manager of corporate development U.S.A., and Martin Donohue from Burmah's Castrol Division (II 21-2). At the inception of the meeting the Geon people were told they were meeting with representatives of Castrol; they did not know they were meeting with anyone directly from Burmah, and business cards were not exchanged (II 22-3). The meeting lasted about one half hour during which the Burmah people asked some very general questions about the prospects for Geon's business, the future of the replacement parts business in the United States and some questions about people active in the company (II 23-4). At the close of the meeting it was agreed that Geon would provide certain information to Burmah.

* References to the appendix are by volume and page.

** Peter Neuwirth is the son of defendant George Neuwirth.

However, there was no arrangement to have another meeting (II 24).

After the meeting Burmah, through Drexel, Burnham, asked for a Geon management forecast covering what Geon thought it would do in the industry, what the industry was doing generally, as well as pro forma balance sheets and income statements for five years, assuming a growth rate of 20-25 percent per year (II 26). By the third week in August a considerable portion of this information had been transmitted to Burmah (II 27).

In late August or early September, 1973 David Gavrin of Drexel, Burnham arranged a dinner meeting at the Harvard Club (II 27-8). It was a social gathering arranged by Drexel, Burnham and attended by representatives of Geon and Burmah (II 28).

As of October, 1973 the only information concerning Burmah that Geon had in its possession was Burmah's 1972 annual report, and one or two contemporaneous Standard & Poor reports (II 35). Since Neuwirth planned to go to England to attend a motor show, Bloom suggested that he visit Burmah to meet some of the people at its head office and try to learn something about the company (II 35).

Prior to traveling to England in October, 1973 Neuwirth had a conversation with Alpert. With regard to that conversation, Alpert testified as follows:

> "I believe that some [time] during a social evening Mr. Neuwirth had mentioned something to the effect that there was an acquisition or a sale taking place in his business." (III 322).

Neuwirth remembers having said to Alpert: ". . . I am going to London . . . I am going for the auto show, and perhaps looking at some people in view of a merger . . ." (II 215). Further in Mr. Neuwirth's testimony about this conversation with Alpert, Neuwirth stated that he had said: "I am going to look at some people regarding a possible merger. . . ." (II 216).

Within a week after this conversation, Alpert purchased 2,600 shares of Geon stock (III 321-4).* Alpert testified that this conversation was one of the reasons why he bought the stock. The other reason was that for a period of years, Alpert knew that Neuwirth had a very successful, solid business (III 323-4).

Neuwirth testified that at no time prior to his trip to London did he discuss with Alpert the meetings and discussions he had had with Burmah (II 215).

Alpert testified that the first time he heard that Geon was having discussions with Burmah was when he read about it in the newspaper** (III 344).

Neuwirth arrived in England on October 15, and for the first week of his stay, he attended the motor show. It was not until a week after he arrived in England that he visited Burmah (III 309-10). According to Neuwirth he met with Peter Simonis (an officer of Burmah who later turned out to be Burmah's chief negotiator vis-a-vis Geon) for 10 to 15 minutes before lunch (III 224). Neuwirth summed up the conversation that took place as "chit chat" (III 224-5). Thereafter, everyone sat down to lunch during which no business was discussed (III 227).

Thereafter, George Neuwirth, Peter Neuwirth and Bloom met with Simonis, and Simonis delivered what George Neuwirth characterized as a monologue, during which Simonis said ". . . the company seems to be in good shape, we like you, you look like a nice bunch" (III 229). Neuwirth did not respond with anything salient (III 230). There were no further meetings with Burmah in England (III 230, 232). There was no timetable set for meeting again nor any discussion of holding further discussions (III 232).

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* Alpert testified that his brothers also purchased Geon stock at that time (III 325), but the number of shares purchased by them does not appear in the record.

** The first time any reference to Geon-Burmah discussions appeared in the newspaper was following the issuance of Geon's press release of December 3, 1973 (SEC Exhibit 1, I 75a).

According to Bloom the entire meeting, including lunch, lasted about 2½ hours (II 38). In characterizing the meeting Bloom testified: "The essence of the meeting was really to meet Peter Simonis and sort of look at him, see what he was like and let him take a look and see what we were like" (II 38).

Prior to the trip to England, Joseph Lucas & Company, a British company, indicated an interest in speaking to Geon. While Neuwirth and Bloom were in England, they met with some people from Lucas in London (II 36-8), but nothing ever came of the discussions.

On November 20, 1973 representatives of Geon and Burmah met for dinner at the New York Athletic Club (II 61). It was then that Burmah first indicated that it was interested in negotiating a transaction with Geon, and a date for such negotiations was set (II 61-2).

Sometime in November, 1973 Burmah, for the first time, sent some of its operating people to visit Geon's premises (II 168). At that time they toured Geon's east coast and west coast facilities (II 41-2). The first time any of Burmah's accounting people visited Geon's premises was after the Thanksgiving weekend in 1973 (II 169). After the Thanksgiving weekend, for the first time, Bloom asked Arthur Andersen & Co., Geon's accountants, to make its workpapers for the prior year available to Ernst & Ernst, Burmah's accountants (II 43-4).

On December 3, 1973 Geon issued a press release (SEC Exhibit 1, I 75a) stating that it was engaged in preliminary discussions looking to the possible acquisition of Geon by Burmah.

On December 17, 1973 representatives of Geon and Burmah met to begin negotiations of a transaction (III 266). Burmah offered $30,000,000 and then $32,000,000 both of which offers Neuwirth declared to be unsatisfactory (III 266-7). Neuwirth inquired as to the basis for the offer, and Mr. Nuland, one of the Burmah representatives, stated that it was based on certain projections prepared by Burmah (III 267). When Bloom questioned the projections, it was

agreed that Bloom and Nuland would work up a new joint projection (III 267).

On the same day, December 17, Neuwirth told Alpert that he could not attend a birthday party that had been planned for Neuwirth because he was staying in New York City on business (III 262-4, 344). Neuwirth did not tell Alpert he was talking to Burmah (III 344).

On the following day, December 18, Geon issued a press release (Geon Exhibit D, I 172a) which ran on the Dow Jones broad tape. That press release stated:

> "Geon Industries, Inc. (AMEX) which announced on December 2, 1973 that it was engaged in preliminary negotiations looking to the possible acquisition of Geon by a subsidiary of The Burmah Oil Company Ltd. said today that in response to inquiries that its negotiations with Burmah are continuing. Geon said that it expected to make a further announcement based upon developments in the negotiations probably by the end of the week."

"Around" December 19, 1973 Alpert and his brothers purchased a total of 3,000 shares of Geon stock (III 330, 344).* At the time of those purchases, Alpert did not know that Neuwirth was having conversations with Burmah (III 344).

On December 20, 1973 Geon issued a press release stating that its Board of Directors had approved an agreement in principle with Burmah for the acquisition of Geon by Burmah for a price of $36 million in cash (SEC Exhibit 3, I 77a).

Toward the end of 1973 Geon anticipated that it would earn approximately $3.8 million before taxes for the year 1973 (II 145). That anticipated earnings figure was set forth in pro forma financial statements that were given to Burmah and in the proposed purchase agreement between

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* Alpert testified that he and his brothers purchased 3,000 shares of Geon "around" December 19, 1973. No evidence was adduced as to the precise date of purchase.

Geon and Burmah under contemplation in late 1973 and early 1974 (II 145).

In terms of assessing its financial condition and results of operations, Geon has what it refers to as individual profit centers. These are either divisions or subsidiaries of Geon (II 145-6). These independent profit centers are the east coast warehouse, the west coast warehouse, east coast branches, west coast branches, Geon International Corporation, American Aviation Mfg. Corporation and Geon G.M.B.H. (II 146-7).

Toward the end of 1973 Geon had determined the gross profit percentages that would have to be obtained at each profit center in order for Geon to attain the $3.8 million before taxes that it anticipated as its 1973 earnings (II 147-8). As a part of this calculation, Geon had determined that in order to meet anticipated 1973 earnings it would be necessary to experience a gross profit percentage at the east coast warehouse of approximately 36 percent (II 83, 148).

A meeting of the Geon board of directors was scheduled to be held on February 21, 1974 for the purpose of reviewing and approving the proposed written agreement with Burmah. During the week preceding that meeting, Bloom received preliminary data which tended to indicate that the east coast warehouse was achieving a gross profit percentage of around 41 percent or better (II 148). This was approximately five percent greater than the gross profit percentage needed at the east coast warehouse to attain Geon's anticipated earnings for 1973 (II 149). An error consisting of a failure to reverse (*i.e.* eliminate) a $314,000 inter or intracompany profit item, undiscovered during the week prior to the February 21 board meeting, created the appearance of a gross profit percentage at the east coast warehouse in the 41 percent range as opposed to the anticipated 36 percent (II 84, 149-50).

On the morning of February 21, 1974 Bloom first became aware of the likelihood that this $314,000 error had been

made (II 118, 122). By that evening, Bloom was sure that the error had been made (II 129).

When the existence of the error was discovered on Thursday, February 21, the correction of the error indicated that instead of 41 percent, Geon was experiencing a gross profit of 37½ percent at the east coast warehouse, or still 1½ percent *higher* than was necessary to meet Geon's anticipated earnings for 1973 (II 84-5, 150). When the audit conducted by Geon's independent certified public accountants, Arthur Andersen & Co., was completed in March and an audit adjustment of a cutoff error was made, the actual and final gross profit percentage at the east coast warehouse was determined to be 39 percent or three percent *higher* than that which was necessary to meet Geon's anticipated 1973 earnings (II 85, 150).

Also on the morning of February 21, 1974 Bloom received certain data from Mr. McMahon, controller of one of Geon's subsidiaries, with regard to Geon's branch stores (II 151). "That data indicated that the branches were assuming [sic] in with preliminary gross profits that were substantially less than those we had anticipated and that the branches' gross profits would be off in the neighborhood of 6, 7, 800,000 dollars if that data were correct"* (II 151). With regard to his opinion of that data, Bloom testified that he thought it was absolutely ridiculous (II 151).

With respect to why he concluded that the data was "absolutely ridiculous", Bloom testified as follows:

> "A. Well, item 1, we have never experienced a gross profit problem either at the warehouses or at the branches in any prior periods.

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* At the same time, Bloom received information which tended to indicate that the gross profit margins at the Aviation Export Division were below anticipated to the extent of $180,000 indicating the possibility of a shortfall of approximately $900,000 in total (II 124).

"Item 2, we monitor in a mechanical way the approximate gross profit percentages being achieved based on mix by the branches during the course of the year, and there were absolutely no indications that their gross profits would be off that far.

"Based upon their historical growth [sic] profits we had reported for the first nine months earnings pretax about $2,900,000.

"Q. The data that you received from Mr. McMahon on Thursday morning, was there any breakdown as to expenses?

"A. No. Expenses were all in one line item. There is no detail available on anything. As a matter of fact, no final inventory figures were set forth in balance sheet form, no inter-company accounts had been reconciled, no account payable accounts had been reconciled.

"There wasn't a section of the balance sheet that was done, there wasn't any of the detail on operating expenses that was done. Nothing was done on the bad debt — I could go on and on endlessly." (II 152).

On the afternoon of Thursday, February 21, 1974, Bloom attended the Geon board of directors meeting (II 153). He apprised the board of directors of the data that had come to his attention, and both he and Peter Neuwirth, Geon's president, stated that they did not find this data to be believable (II 122, 153, III 290). There was a discussion of the proposition that if, in assembling the data, a couple of branches had been left out of the computation, that would account for the entire $700,000 shortfall (II 122).

It was agreed at the board of directors meeting that since the data was unconfirmed and unreliable, and given the importance of the pending transaction with Burmah, it was necessary that the discussion be kept in the utmost confidence (II 154-5). Based upon Bloom's assessment of the time necessary to reach conclusions, it was agreed that Bloom would perform the necessary work and report to the

board on Sunday night, February 24, 1974 (II 127, 155, III 292).

With regard to his activities on Thursday night relating to the possible $800,000 discrepancy, Bloom testified as follows:

> "A. . . . we couldn't really address ourselves to it properly. As I indicated, as I started to indicate, the only process I went through was to look for the obvious things, to see if of the branches that we had detail on, if one or two branches, if their closing inventories had not been booked up, because that could wipe out the difference immediately, just like that.
>
> "Also to see whether some of the accumulated totals that were carried forward on work sheets, if there was just a mechanical footing error. . . ." (II 158).

When Bloom left the Geon premises at 12:15 a.m. on Friday, February 22, the $800,000 shortfall looked just as ridiculous to him as it had earlier, and he didn't believe that the data were true (II 159).

On the morning of Friday, February 22, prior to the opening of Geon stock for trading, Randy Gromet, a listing representative with the American Stock Exchange, placed a call to Bloom. Prior to accepting Gromet's call, Bloom called John A. Friedman, Esq., a member of the firm of Kaye, Scholer, Fierman, Hays & Handler, counsel to Geon, and informed Friedman that Gromet was on the phone (II 133, IV 528). Friedman asked Bloom if he knew any more facts than he had known the previous day, and when Bloom said that he did not, Friedman advised him to advise Gromet that the Company had no public announcement to make (II 133-4, IV 528-9).

Both Gromet and Bloom agree that Gromet stated to Bloom that there was an imbalance of sell orders in Geon stock* (II 135, III 369). Bloom testified that Gromet stated

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* "Imbalance" meaning more shares offered for sale than offers to buy.

that the imbalance was not large in view of the fact that the buyers or arbitrageurs were willing to pick up 6-8 thousand shares of the 10,000 shares offered for sale prior to the opening (II 162). Gromet denied having made that statement to Bloom (III 407). Gromet testified that David Foster, an American Stock Exchange floor official, told him that there was a substantial imbalance of sell orders, that there were 10-11 thousand shares for sale, but that Foster did not give him the buy side and he did not know the buy side (III 397).

Squarely contradicting Gromet's testimony is the testimony of Foster. Foster testified that he did not tell Gromet there was an imbalance in sell orders because their was no imbalance (IV 458-9). Foster also testified that he is "sure" that he told Gromet that the arbitrageurs were prepared to buy all the stock offered for sale prior to the opening (IV 459). Foster had gotten his information about the "sell" and "buy" orders directly from the specialist in Geon stock and from the arbitrageurs who had placed the "buy" orders (IV 450-1).

As Bloom testified, Gromet suggested that it was taking an inordinate amount of time between the announcement of an agreement in principle between Geon and Burmah and the execution of a final agreement (II 136). Bloom responded that it takes time to hammer out a contract satisfactory to both parties (II 136). With respect to this conversation, Bloom further testified:

> "And he asked me if the company had any announcements to make this morning, that morning, and I said no, the company has no announcement to make, and then he said to me, well, I hope you are not going to tell me that you are not making an announcement this morning, but that—and then you will make an announcement this afternoon.
>
> "I said, Randy, the company definitely has no announcement to make today. I specifically made that point." (II 137-8).

When Geon stock opened for trading that morning, it opened at 14⅜, down 37½ cents from the previous day's closing price (IV 462). Later in the morning, it came to the attention of Geon's counsel that Geon stock had dropped sharply on big volume, and that the price was then 13⅞ (IV 533-4). At that juncture, Geon's counsel called the American Stock Exchange and requested that trading be halted (IV 535).

Bloom continued to work throughout the weekend in an effort to ascertain Geon's earnings (II 163). It was not until Sunday, February 24, that Bloom was able to reach any conclusions with regard to the possible shortfall from Geon's anticipated earnings (II 163). At that time, Bloom discovered a shortfall of approximately $800,000 in gross profit at the branches, brought about because Geon's pricing structure had failed to take into account certain factors (II 163-4).

On Sunday evening, February 24, 1974, Bloom reported his findings to Geon's board of directors (II 165-66). The next day, Monday, February 25, Geon issued a press release stating that its 1973 earnings are preliminarily expected to be in the area of $1.4 to $1.5 million or about $.70 per share, approximately 10 to 15% below 1972, and that at the currently estimated level, Geon's 1973 earnings would be appreciably below that on which Geon's agreement with Burmah Oil Incorporated was negotiated. (SEC Exhibit 10, I 87a-88a).

During the evening of Wednesday, February 20 (the day before the meeting of Geon's board of directors at which Bloom reported the preliminary data), Neuwirth, Alpert and their wives had their traditional Wednesday dinner together (III 281, 331). According to Alpert, Neuwirth stated that "... the board was meeting the following afternoon to wrap up the deal with Burmah. . . ." (III 331). Neuwirth recalls that he said he was going to a board meeting "to rubber stamp an agreement" (III 282).

Neuwirth did not tell Alpert that he would call him and tell him what had happened at the board meeting, and there

was no discussion of either getting together or calling Alpert the next day (III 283, 338-9). Neuwirth did not call him after the board meeting and the two did not speak to each other either on Thursday or Friday (III 338-9).

Nevertheless, Alpert "assumed" that Neuwirth would call him to tell him that all had gone well (III 333). When, by Friday morning, Alpert had not heard from Neuwirth, he suggested to his brother that they sell half of their Geon stock (III 334). Later that morning, Alpert's brother informed him that after he had sold half of their Geon stock (approximately 4,200 shares) at 14¼, the broker said he could sell the balance at 14⅜ and that he had taken it upon himself to sell the balance (III 336).

* * *

During the latter part of 1973, and early 1974 Neuwirth had a number of conversations with defendant Marvin Rauch. Rauch was called by the SEC as a witness at trial, but he declined to testify, asserting his rights under the Fifth Amendment (III 360). The SEC offered a transcript of Rauch's testimony taken during a private SEC investigation, but the District Court ruled it inadmissible (V 865).

Neuwirth testified that he first met Rauch at Geon's 1970 annual meeting (III 234). Neuwirth next met Rauch at Geon's 1971 annual meeting (III 236).

In October, 1973 Rauch said to Neuwirth that he had heard that somebody had made a study of Geon and had issued or was about to issue a write-up (III 220). Neuwirth told Rauch that the report had been prepared by Coenen & Company, a brokerage firm, and that the individual author was Mark Boyer (III 220).

On November 21, 1973, Neuwirth had lunch with Marvin Rauch (III 246-7). Neuwirth gave Rauch some recently issued sales brochures (III 249, Geon Exhibit A, I 161a-164a). When Rauch complained that Geon stock wasn't doing well, Neuwirth responded "Let's hope for better days" (III 251). Neuwirth did not discuss Burmah with Rauch (III 253).

One evening of unknown date, Neuwirth called Marvin Rauch at home (III 255-6). This resulted from the fact that Neuwirth had left his office early, and Rauch's name was among those given to Neuwirth by his secretary as having telephoned in Neuwirth's absence (III 256-7). Neuwirth does not recall the content of the conversation (III 257), but he is sure he didn't discuss Burmah because he considered that "a taboo subject" (III 258).

Aside from annual meetings of the stockholders of Geon, the only time Neuwirth ever met with Rauch was the day they had lunch (III 312). Neither has ever been to the other's office or home (III 312). At no time did Neuwirth ever inform Rauch of the status of the negotiations or discussions between Geon and Burmah (III 314).

The Proceedings Below

This action was commenced by the filing of a complaint by the SEC in the United States District Court for the Southern District of New York on April 2, 1974. More than six weeks later, on May 17, 1974, the SEC served and filed a motion for a preliminary injunction against all of the defendants.* The District Court ordered an evidentiary hearing, and, with the consent of all parties, the District Court consolidated the hearing on the motion for a preliminary injunction with the trial on the merits. Defendants McMahon, Rauch, Roy Alpert and Irving Alpert, without admitting or denying the allegations of the SEC, consented to the entry of judgments preliminarily and permanently enjoining each from further violations of Section 10(b) of the 1934 Act and Rule 10b-5 promulgated thereunder.

Commencing on June 17, 1974 a trial was held before Hon. Dudley B. Bonsal, District Judge.

On September 23, 1974 the District Court filed its opinion, holding that defendant Neuwirth had violated Section 10(b) of the 1934 Act and Rule 10b-5 thereunder and that defen-

* Named as defendants in the complaint were Geon, Neuwirth, Bloom, McMahon, Edwards & Hanly, Rauch, Roy Alpert and Irving Alpert.

dant Geon was liable by virtue thereof. The District Court dismissed the complaint as to defendants Bloom and Edwards & Hanly.

On October 21, 1974 judgment was entered.

ARGUMENT

Point I

This Court should affirm the District Court's dismissal of the complaint as to Bloom.

The SEC appeals herein from the District Court's dismissal of the complaint as to defendant Bloom.

The gravamen of the SEC's charge against Bloom was that, at the time of his conversation with Gromet, he had knowledge of adverse facts concerning Geon's income for the year ending December 31, 1973. The District Court found, however, that Bloom had no such knowledge at the time. The trial court also found that Bloom acted in good faith and in a careful and reasonable manner, and that Bloom sought and acted upon the advice of counsel. In light of such findings the Court held that Bloom did not violate Rule 10b-5, and dismissed the complaint as to him. It appears that the SEC's appeal is bottomed upon the argument that the District Court's findings of fact with respect to Bloom are erroneous.

A trial court's finding of fact may be reversed only upon a showing that such finding is clearly erroneous. Rule 52(a), Federal Rules of Civil Procedure. As will appear, the SEC has made no demonstration that the Court's findings of fact with respect to Bloom are clearly erroneous. Indeed, the SEC has failed to point to any evidence which contravenes these findings. It will be shown that the evidence in the record fully supports the District Court's findings of fact.

The SEC's specific contentions with respect to Bloom, as argued in the District Court, are succinctly stated in the Opinion of Judge Bonsal as follows:

"The SEC contends that defendant Bloom made misrepresentations to Randy Gromet of the AMEX when Gromet telephoned on February 22, 1974 to determine what information Geon might have to explain the large number of sell orders with respect to Geon's stock. The SEC contends that Bloom omitted to tell Gromet of the discovery of the $314,000 error and that Bloom did not disclose to Gromet certain preliminary information which tended to indicate an approximate $800,000 shortfall in Geon's 1973 earnings." (I 63a).

A. The $314,000 Error

The $314,000 error is briefly mentioned in the factual portions of the SEC's brief. Thus, at pages 16-17 it is pointed out that at about ten-thirty on the morning of February 21, 1974 Bloom learned that it was possible that a $314,000 inter or intra-company profit item had not been eliminated from the financial statements (although it should have been eliminated) and that later that evening Bloom was able to confirm that in fact this $314,000 error had been made.

However, this $314,000 error is not mentioned at all in the eight pages of argument devoted by the SEC in its brief to the appeal with respect to Bloom. Thus, it may well be that the SEC is abandoning its argument that Bloom violated the law by failing to tell Gromet about the discovery of this $314,000 error. However, since the SEC has not explicitly abandoned this argument, it must be discussed.

On the subject of this $314,000 error, the District Court found the facts as follows:

"Toward the end of 1973 Geon anticipated that it would earn approximately $3.8 million before taxes for the year 1973; these figures were furnished to Burmah during the negotiations concerning the possible merger in late 1973 and early 1974. To attain those earnings, Geon had calculated that it would need a gross profit percentage at the east coast warehouse of approximately 36%. During the week preceding the February 21, 1974 meeting, preliminary figures indicated a profit

> percentage of 41%. When the error in the figures of $314,000 was discovered on the morning of February 21, 1974, this percentage was reduced to 37½%, which was still higher than necessary to meet Geon's anticipated earnings for 1973. When the audit conducted by Geon's independent certified public accountants, Arthur Andersen & Co., was completed in March of 1974 and an audit adjustment of a cutoff error was made, the actual and final gross profit percentage at the east coast warehouse was determined to be 39%." (I 64a-65a).

The Court also stated:

> "[I]ndeed, final calculations showed that the $314,000 error by itself had no adverse bearing on Geon's ability to meet its anticipated 1973 earnings and to conclude the deal with Burmah since the east coast warehouse's final profit percentage was higher than anticipated, even with the $314,000 error." (I 66a).

The above-quoted findings of fact are fully supported by the evidence.* The SEC's brief may be searched in vain for a reference to any evidence which even arguably contradicts the District Court's findings. Consequently, the suggestion that in failing to apprise Gromet of the discovery of the $314,000 error, Bloom misled the American Stock Exchange or omitted to state a material fact is totally without merit.

B. The $800,000 Shortfall

The SEC appears to argue that Bloom violated Rule 10b-5 by failing to reveal to Gromet on the morning of February 22, 1974 his knowledge with regard to a possible shortfall of $800,000 with respect to Geon's anticipated 1973 earnings.

It is clear that Bloom's response to Gromet should not be judged with hindsight; it can only be judged in light of what Bloom then knew, the attempts he made to check the

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* See pages 8 and 9, *supra,* and the citations to the record contained therein. Bloom, called as a witness by the SEC, was the only person to testify on the subject of the $314,000 error.

data in his possession, and the advice he received from counsel. With respect to these considerations, the Court found the facts as follows:

> "With respect to the possible $800,000 earnings shortfall, Bloom testified that at first he thought it was 'absolutely ridiculous' since Geon had never before experienced a gross profit problem either at the warehouses or at the branches, and also since the running estimates of profits which were kept during the year had given no indication that profits would be so far off. *At the time of the conversation with Gromet, Bloom was still uncertain about the accuracy of the figures showing a possible $800,000 earnings shortfall.*" (I 65a) (emphasis supplied).
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> * * *
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> "With respect to his conversation with Gromet on February 22, Bloom testified that when Gromet telephoned him, he put him on 'hold' and immediately telephoned John Friedman, of the law firm of Kaye, Scholer, Fierman, Hays & Handler (Geon's attorneys). Bloom told Friedman that Gromet was on the other line and that he did not know why Gromet was calling. Friedman asked if Bloom knew anything more about the possible error of $314,000 or the earnings shortfall of $800,000 than he had known the evening before. Bloom said no. Friedman then told him to tell Gromet that Geon had no public announcement to make that day. Bloom then accepted the call from Gromet, who advised him that there was a substantial imbalance of sell orders in Geon stock. During the conversation, Bloom told Gromet that Geon would have no public announcement to make that day." (I 63a-64a).
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> * * *
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> "[W]ith respect to the earnings shortfall, when it was determined that Geon would in fact fall short of anticipated earnings, a public statement to that effect was promptly disseminated. *However, as of the morning of February 22, Geon had only raw, unverified information, which might have been misleading had it been*

made public. Moreover, it is significant that Bloom sought and followed the advice of counsel in telling Gromet that Geon would have no public announcement to make on February 22, 1974." (I 66a) (emphasis supplied).

Based on these findings of fact, the Court concluded:

"Having heard the testimony of the two witnesses to the conversation, the Court does not find that Bloom violated the securities laws with respect to his conversation with Gromet on February 22, 1974. The evidence brought out at the hearing shows that Bloom acted in good faith and in a careful and reasonable manner in attempting to check the accuracy of the preliminary figures indicating a $314,000 error and the possible $800,000 earnings shortfall. . . ." (I 66a)

The Court also concluded that Bloom had acted "with reasonable care and prudence" (I 67a).

C. The Dismissal of the Complaint as to Bloom Should Be Affirmed

While the point heading appearing at page 48 of the SEC's brief states that the District Court "erred" in failing to find that Mr. Bloom had violated Rule 10b-5, it is difficult to discern from that brief the way in which it is alleged that the Court so erred. There does not seem to be any assertion that the District Court employed an erroneous legal standard or committed any other error of law. On the other hand, it appears that the SEC is attacking the District Court's findings of fact, but in so doing, the SEC neither identifies the specific findings it questions nor makes a showing that any such findings are clearly erroneous.*

* At pages 48-9 of the SEC's brief, in speculating as to how the District Court could have concluded that Bloom did not violate the securities laws in his conversation with Gromet, reference is made to some of the District Court's findings; but no reference is made to the findings of fact with respect to the $314,000 error, and the finding—"At the time of the conversation with Gromet, Bloom was still uncertain about the accuracy of the figures showing a possible $800,000 earnings shortfall" (I 65a), each of which is key to the District Court's conclusion with respect to Bloom.

At pages 49-50 of its brief, the SEC asserts, as if it were true:

> "Mr. Bloom knew that corporate insiders were aware that the previously-announced prospects for a merger were in jeopardy and that attempts by these insiders or their tippees to take advantage of the knowledge could well have resulted in the heavy imbalance in sales orders. . . ."

These assertions fly in the face of the facts as found by the District Court. The SEC doesn't cite a single fact in the record to support its assertion. Nor could the SEC cite such a fact because the uncontroverted evidence adduced at trial demonstrates that on February 22, 1974 Bloom had no knowledge that the prospects for a merger were "in jeopardy" or that "insiders" or "tippees" were selling or might sell Geon stock. Indeed, there is no evidence that Bloom had any knowledge of the existence of any person who might be characterized as a tippee. Moreover the "heavy imbalance in sales orders" referred to on several occasions in the SEC's brief is not fact but rather a fiction created by the SEC. According to the testimony of David Foster, an American Stock Exchange floor official called as a witness by the SEC, there was no imbalance of sales orders prior to the opening on February 22. As Foster knew from having spoken to the specialist, and the arbitrageurs who wanted to buy, there were buyers for all the shares offered for sale (IV 450-51).

On page 49 of its brief, the SEC asserts that Mr. Bloom "deceived" the American Stock Exchange and on page 51 of its brief it is argued that Mr. Bloom "made false and misleading statements to Mr. Gromet." While these assertions are made as if they were fact, they contravene the facts found by the trial court. And here again, the SEC is unable to cite any fact in the record to support its contention.

At page 49 of its brief, the SEC recognizes that the District Court found as fact that on the morning of February 22, 1974, "Geon had only raw, unverified information,

which might have been misleading had it been made public'' (I 66a). Instead of meeting that finding head on, the SEC tries what may be characterized as an end run by arguing that the American Stock Exchange is not ''the public'' and, therefore, telling something to the American Stock Exchange is not telling it to the public. Even more, the SEC seems to be arguing that there exists a legal obligation to provide certain information, however raw and unverified,* to the Exchange, failing which constitutes a violation of Rule 10b-5. Once more, the SEC cites no authority for this proposition.

In any event, no useful purpose would be served by trying to answer the essentially metaphysical question of whether the American Stock Exchange is or is not the public. The purpose of Mr. Gromet's call was to solicit information for public dissemination. As Mr. Bloom testified, Gromet inquired whether Geon had a public announcement to make (II 137-8). This is confirmed by Mr. Gromet's testimony:

> ''I wanted to be sure that there was nothing pending because the last thing in the world the exchange would want to see would be any kind of an announcement at all after a substantial sell off, or a substantial amount of volume in the stock. And Mr. Bloom assured me then that the company had no announcement to make.'' (III 371).

This was not the first time Gromet had solicited information for public dissemination from Bloom. As Gromet testified, on November 30, 1973 he learned that trading in Geon was active (III 390). After the close of the day's trading, he spoke to Bloom who informed him that Geon was having discussions with Burmah (III 390). It was decided that a press release would be issued prior to the opening of trading on the next trading day (III 390-92).

Similarly, as Foster, the Exchange Floor official testified, the inquiry to Geon on the morning of February 22 was initiated by a call to Foster by the Geon specialist (IV

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* The SEC does not seem to be attacking the District Court's finding that the information in Bloom's possession was raw and unverified.

449), who after all is a stockbroker. Foster called Gromet "and asked him if he would find out anything he could and get back to [him] as quickly as possible" (IV 452). Foster went back to the specialist and told him not to open Geon stock until he returned (IV 452). Mr. Foster succinctly stated the whole point of the inquiry:

> "[W]e have a responsibility to make sure the public has all the information so that we can open the stock at a fair price to the buyers and the sellers." (IV 452)

The sum and substance of Frank Bloom's actions may be stated as follows—he declined, upon advice of counsel, to disseminate to *anyone* raw, unverified data which he personally disbelieved. The SEC says that that is a violation of law. The District Court correctly rejected that contention and held that Mr. Bloom acted in good faith, with reasonable care and prudence.

The need to refrain from disseminating unverified and disbelieved data is underscored by an article appearing on page 14 in the April 9, 1975 *Wall Street Journal*. The article has the headline "U.S. Is Investigating Possible Law Violation by Employes of Amex". The article states in part:

> "The U.S. Attorney's Office here is investigating the possibility that some American Stock Exchange employes may have violated federal securities laws, industry sources disclosed.
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> * * *
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> "There are indications that the federal investigators are looking to see whether any Amex employes traded in the stock market on inside corporate information they obtained in the course of their jobs, which involve monitoring trading on the exchange. Often such information is obtained by exchange surveillance personnel from listed companies after the personnel notice unusual price and volume action in a stock, and query the companies about reasons for the action.
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> * * *
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> "The exchange official placed on a leave of absence last week is vice president Steven L. Gerard, 30 years old, one of the exchange's youngest and most highly

regarded executives. Mr. Gerard, in confirming last week that he was placed on leave at his own request, added that he didn't believe he had done anything wrong, and that the matters under scrutiny had occurred five years ago.

"The identity of the second Amex employe placed on leave was learned yesterday. He is Randy Gromet, a subordinate of Mr. Gerard's. He is responsible for monitoring the market activities of shares of about 100 Amex-listed companies. Mr. Gromet couldn't be reached for comment."*

With regard to Bloom, there is one question that the SEC assiduously avoids—What motive could Bloom conceivably have had for misleading Gromet? On earlier occasions in this case, the SEC suggested that Geon was trying to close the Burmah deal before any earnings shortfall would become known to Burmah. Such a contention is nothing short of nonsense. The contract between Geon and Burmah that was then under consideration** contained, *inter alia,* the following provisions:

1. That as a condition to closing, Geon's 1973 pre-tax income as reflected in an audited income statement to be prepared by Arthur Andersen & Co., would equal or exceed $3,847,000 (Sections 4.5(b) and 7.2.5)
2. That upon delivery of Geon's 1973 financial statements certified by Arthur Andersen & Co. Geon would instruct Arthur Andersen & Co. to give Ernst & Ernst, Burmah's accountants, access to their workpapers in connection with their audit. (Section 6.3)

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* Mr. Gerard is one of the Amex officials to whom Geon's lawyers spoke on the morning of February 22, 1974. Mr. Gromet is the same Mr. Gromet who spoke to Mr. Bloom on the morning of February 22, 1974.

** The draft contract is contained in SEC Exhibit 9, a portion of which is reproduced in the Appendix, I 84a.

If the SEC were to suggest that Bloom or Geon hoped to "sneak" past Arthur Andersen & Co., Ernst & Ernst and Burmah without revealing that its earnings were below the contract condition, if such were the case, the suggestion would be absurd.

The SEC has also suggested previously that Geon and Bloom had hoped to avoid a public announcement that Geon's earnings were below anticipated, if such proved to be the case. As a public company whose stock is traded on the American Stock Exchange, Geon is required to file its audited year-end financial statements with the Exchange and to include such statements in its annual report to stockholders. Thus, it cannot be that Geon or Bloom hoped to get by without a public announcement of an earnings shortfall, if a shortfall eventuated.

Bloom acted in the only reasonable fashion—declining to disseminate any information unless and until it was verified to be accurate, while at the same time bending every effort to find out as quickly as possible the true state of facts. On Thursday, February 21, after Bloom left the Geon board of directors meeting, he went back to his office and worked until after midnight (II 129, 159). Thereafter, he spent the entire weekend working with his staff on the numbers (II 163).

Consistent with its policy of disseminating facts, as opposed to unverified information which was disbelieved, when Geon learned on Sunday, February 24, that in fact there was an approximate $800,000 shortfall at its branches, it immediately issued a press release disclosing the facts (SEC Exhibit 11, I 87a-88a).

At pages 51-52 of its brief, the SEC argues that the materiality of Bloom's unconveyed knowledge is proven by the sales of stock by "insiders and tippees".* In the instant case, however, the evidence demonstrated, and the District Court found that on the morning of February 22, 1974

* It should be noted that Bloom did not trade in the stock of Geon nor did he "tip" or provide information to any other person, nor did he have any knowledge of trading by insiders or tippees.

Bloom was not in possession of "facts", material or otherwise. All he had was the possibility of an earnings shortfall, which he himself did not believe. Thus, the SEC's citation to the *Texas Gulf Sulphur* case for the proposition that "a major factor in determining whether [information] was a material fact is the importance attached to [it] by those who knew about it", misses the point. The *Texas Gulf Sulphur* case dealt with the question of whether the results of the K-55-1 discovery hole, an undoubted "fact", was material. Here, as the District Court found, Bloom "had only raw, unverified information, which might have been misleading had it been made public" (I 66a).

The thinness of the SEC's argument is best illustrated by the sentence with which it concludes the point, wherein they articulate the nature of the "knowledge" which they claim Bloom had—"Accordingly, it is appropriate to evaluate materiality by the conduct of those persons who knew or had reason to suspect that a hitch had or might develop in the merger negotiation" (SEC Brief, p. 52). The class of persons who "had reason to suspect" that a hitch "might develop" in the merger negotiations probably includes all those persons who at any time had ever heard about the plans for a merger. As to the persons who knew on the morning of February 22 that a "hitch" (whatever that means) had developed in the merger negotiations, the answer is simple. There were none.

In assessing Bloom's conduct, the District Court noted that he sought and obtained the advice of counsel prior to speaking to Gromet. It appears that the SEC seeks to attack the significance of that finding by arguing that at the time counsel advised Mr. Bloom, counsel did not know (1) that there was a "heavy imbalance in sales orders" and (2) that Bloom would be asked specifically whether there had been significant corporate developments or any change in the status of the Burmah negotiations.

In the first place, and most important, the prudence and good faith evinced by Bloom in seeking and following the advice of counsel is in no way affected by what counsel did

or did not know.* Secondly, as Foster testified, there was no imbalance in sales orders. There were buyers for all the shares offered for sale prior to the opening, and Mr. Foster so informed Mr. Gromet (IV 450-1, 458-9). And when the stock was permitted to open on the morning of February 22, it was off only 37½ cents from the previous day's close (IV 451, 462)—hardly an indicator of heavy selling pressure. To the extent that the SEC is arguing that counsel's advice to Bloom would have been different had counsel known the specific questions that would be put to Bloom, it should be observed that the SEC offers no evidence or authority for that proposition. On the contrary, the testimony of John A. Friedman, the attorney who spoke to Mr. Bloom, indicates that his advice would have been the same. Thus, Mr. Friedman testified that at the board of directors meeting of February 21, the state of knowledge that existed was "dubious" and that it was decided to say nothing, because either saying too much or saying too little would invoke liability (IV 549-50).

In sum, the uncontroverted evidence shows that Bloom was in no position to disclose the information that came to his attention on Thursday, February 21, 1974 because it was raw, unverified data which he believed to be completely inaccurate. If Bloom had disclosed that Geon had preliminary data which appeared to indicate that the earnings would be lower than anticipated, and it turned out that the earnings were equal to or above those that had been anticipated, Geon would have been subjected to suit by all those who might have sold on such disclosure. On the other hand, if Bloom had said that Geon's earnings for 1973 would be equal to the earnings that were anticipated and it turned out that there was a shortfall, Geon would have been subjected to suit by all those persons who might have purchased Geon stock on the basis of such a statement.

With the facts then in hand, a request by the company to halt trading "pending a determination of whether or

* Obviously, before they spoke Bloom could not have known what Gromet would say.

not Geon's 1973 income would be substantially below anticipated,"* could have resulted in horrendous consequences. If it later turned out that the earnings were equal to or better than anticipated, Geon would have been required to communicate to its stockholders and Burmah that a potential $800,000 shortfall in earnings at the branches had proved to be a false alarm. The public and private conclusion would have been that Geon had acted foolishly and precipitously in halting trading without facts, thereby endangering the merger transaction with Burmah.

Point II

The District Court erred in finding that Neuwirth communicated material non-public information to Rauch and Alpert.

The District Court found that Neuwirth violated Rule 10b-5 by providing material, non-public information to Marvin Rauch and Roy Alpert, upon which information Rauch and Alpert traded in the stock of Geon. As will appear, the District Court's finding that Neuwirth provided material, non-public information to Rauch is clearly erroneous because there is *no* evidence in the record to support that finding.

With respect to the transactions by Alpert, the District Court found that Neuwirth violated Rule 10b-5 in that Alpert and his brothers purchased Geon stock in October, 1973 and again in December 1973, and sold Geon stock in February, 1974 on the basis of material non-public information allegedly provided by Neuwirth. As will appear, there is no dispute as to what Neuwirth said to Alpert on these occasions. The District Court erred in finding that the statements made by Neuwirth constituted "material" information.

A. The Rauch Transactions

After reviewing the evidence adduced at trial, the District Court concluded:

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* Obviously, if Geon requested a trading halt it would have had to tell Burmah and the public why it did so.

> "On the basis of the foregoing, the Court finds that defendant Neuwirth violated section 10(b) of the Exchange Act and Rule 10b-5 with respect to the furnishing of material non-public information to Rauch and Roy Alpert during the period alleged in the complaint." (I 62a-63a).

The plain fact is that elsewhere in the opinion, the District Court made *no finding* of what it is that Neuwirth is supposed to have said to Rauch. The only findings in the District Court's opinion concerning Rauch are as follows:

> "Rauch declined to testify at the hearing, asserting his Fifth Amendment rights. Neuwirth testified that he knew Rauch was a broker and that he was trading in Geon stock. He also testified that Rauch telephoned 'rather frequently' and that in November, 1973 Rauch had insisted on having lunch with him. Neuwirth testified that Rauch asked 'broker's questions' about Geon though Neuwirth did not recall in detail what those questions were or what answers he gave. After the luncheon meeting Neuwirth received two bottles of liquor from Rauch as a gift. Around November 30, 1973 Neuwirth testified that he telephoned Rauch at his home, though he testified that he did not have the faintest recollection of what was said in that conversation." (I 60a-61a).

Later on in the opinion, in discussing the liability of Geon, the District Court made the following observations:

> "The evidence at the hearing discloses that Neuwirth had frequent conversations with securities analysts and with brokers during the period alleged in the complaint. The evidence also discloses that Rauch in particular had numerous opportunities for acquiring inside information from Neuwirth, which information he could have used in his trading of Geon stock." (I 67a).

Thus, with respect to the District Court's finding that Neuwirth communicated material, non-public information to Rauch, this appeal does not involve an argument over the materiality of statements admittedly made. Here we have

no statements at all on which to focus. There is simply no evidence in the record that Neuwirth conveyed any material non-public information to Rauch. Rauch declined to testify, asserting the Fifth Amendment. The SEC sought to introduce a transcript of the testimony of Rauch taken during a private SEC investigation,* but the District Court excluded that testimony (V 865). Thus, the only witness with respect to the Rauch-Neuwirth conversations was Neuwirth. Neuwirth's testimony with regard to his conversations with Rauch may be found in Volume III of the Appendix at 219-220, 232-237, 246-261, 276-280, and 312-314. A review of this testimony demonstrates that there is no evidence whatsoever that Neuwirth conveyed any material non-public information to Rauch at any time.** When the SEC writes its answering brief on this appeal, it will be unable to point out a single bit of evidence that Neuwirth conveyed any material non-public information to Rauch.***

A District Court's findings of fact should be set aside when they are clearly erroneous, Rule 52(a), Federal Rules of Civil Procedure. In the leading case of *U.S.* v. *United States Gypsum Co.*, 333 U.S. 364 (1948), the United States Supreme Court said:

> "A finding is 'clearly erroneous' when although there is evidence to support it, the reviewing court on the entire evidence is left with the definite and firm

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* Counsel for Neuwirth and Geon were not present at the taking of such testimony and, consequently, were afforded no opportunity to cross-examine Rauch.

** Neuwirth testified that he never informed Rauch of the status of the negotiations or discussions between Geon and Burmah (III 314).

*** In its argument with respect to Edwards & Hanly, the SEC makes the following assertion at page 29 of its brief:

> "The evidence as we have seen, pp. 11-14, *supra,* is overwhelming that Mr. Rauch purchased a substantial number of Geon shares during the period that Mr. Neuwirth was supplying him with material non-public information concerning Geon; information that he knew was non-public."

However, at pp. 11-14 of the SEC's brief, no reference to any such evidence may be found.

conviction that a mistake has been committed." 333 U.S. at 395.

Where, as in the instant case, there is *no evidence* to support the finding that Neuwirth conveyed material non-public information to Rauch, *a fortiori* the finding is "clearly erroneous" and should be reversed.

How, then, did the District Court find that Neuwirth had conveyed material non-public information to Rauch? It may well be that the Court made reference to material that was not in evidence—the transcript of Rauch's testimony before the SEC (SEC Exhibits 16 and 16A, not in evidence).*

An indication that this may well have happened can be found in the fact that in discussing the issues with respect to Edwards & Hanly, the District Court stated in its opinion:

> "[I]ndeed, the only direct evidence that Rauch received and acted upon illegal inside information was the evidence of McMahon's telephone call to Rauch in the early morning of February 22, 1974 and the evidence that later that morning he placed sell orders for all the Geon stock in the accounts of McMahon and Maione." (I 70a).

The clear implication of this statement is that there was no evidence that Rauch received or acted upon illegal information coming from Neuwirth.

Wholly apart from the fact that the transcript of Rauch's testimony was not in evidence, it is clear that it would be inherently unfair to base any finding on such testimony. Prior to testifying before the SEC, Rauch testified before the American Stock Exchange with regard to the issues of this case. During the course of his testimony before the SEC, Rauch admitted to having told numerous lies to the American Stock Exchange with respect to these issues, and he admitted to an attempt to get McMahon and his father-in-law Maione to go along with such perjury (SEC Exhibit

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* These transcripts are in the SEC's "Supplemental Appendix", having no volume number.

16A, not in evidence at 212-215, 221-227).* In the second place, the SEC has the power to revoke his license to act as a broker in the securities industry. It does not stretch the imagination to believe that in testifying before the SEC, Rauch might try to curry favor by incriminating someone in whom the SEC exhibited interest. Since Rauch was not cross-examined by the attorneys for Neuwirth and Geon or anyone else having an interest in exposing the falsity of his testimony, the testimony is worthless. In this regard, it must be borne in mind that the District Court itself, when confronted with an offer of this testimony, properly ruled that the testimony was inadmissible (V 865). Finally, it should not go unnoticed that when Rauch asserted the Fifth Amendment, the SEC did not so much as mention the possibility that he had waived that right by testifying under oath during the SEC investigation concerning the same matters.

B. The Alpert Transactions

The District Court apparently concluded that each of the three Alpert transactions in Geon stock — the October, 1973 purchase, the December, 1973 purchase and the February, 1974 sale — was effected on the basis of material non-public information supplied to Alpert by Neuwirth. From this, the District Court concluded that Neuwirth violated Rule 10b-5.

Each of the transactions will be examined, and it will be demonstrated that the District Court erred, in that Alpert was not provided with any material non-public information. On the contrary, it will be demonstrated that all Neuwirth did was make a few innocuous comments in the course of social gatherings, to which comments Alpert applied his own assumptions upon which he then acted, without the knowledge of Mr. Neuwirth.

1. The October Purchase

In October, 1973, Roy Alpert purchased 2,600 shares of Geon stock (III 321-2). Alpert testified that his brothers

* This transcript is in the SEC's "Supplemental Appendix".

also purchased Geon stock at that time (III 325), but the number of shares purchased by them does not appear in the record. These purchases were effected within a week after a conversation between Roy Alpert and George Neuwirth (III 323-4). As will appear, neither the facts concerning these transactions nor the content of the conversation between Neuwirth and Alpert is in dispute. It is the legal significance of that conversation that is here at issue. It will be demonstrated that the statements made by Neuwirth to Alpert did not constitute "material" information concerning Geon.

With respect to these transactions, the District Court's findings of fact are as follows:

> "At the hearing it was brought out that Neuwirth and Roy Alpert had known each other for about 15 years and that sometime prior to October 15, 1973 they were together in the bar of the Fresh Meadows Country Club, where Neuwirth told Alpert and others that he was going to England to an automobile show 'and perhaps looking at some people in view of a merger'. Roy Alpert testified that he purchased 2,600 shares of Geon stock around October 15, and that this information was one of the reasons for his decision to buy the stock. His only other purchases of Geon stock had been a purchase of 250 shares in 1969 in Geon's initial public offering. Between October 15 and October 18, 1973 Roy Alpert and his two brothers purchased a total of 4,625 shares." (I 59a-60a).

It will be shown that in light of the facts as they existed at the time of the October conversation beween Alpert and Neuwirth, prior to Neuwirth's trip to England in October 1973, Neuwirth did not convey any information that was "material" concerning a transaction between Geon and Burmah because no material facts then existed.

With regard to that conversation, Alpert testified as follows:

> "I believe that some [time] during a social evening Mr. Neuwirth had mentioned something to the effect

that there was an acquisition or a sale taking place in his business." (III 322).

Neuwirth remembers having said to Alpert: ". . . I am going to London . . . I am going for the auto show, and perhaps looking at some people in view of a merger. . . ." (II 215). Further in Mr. Neuwirth's testimony about this conversation with Alpert, Neuwirth stated that he had said "I am going to look at some people regarding a possible merger. . . ." (II 216).

Neuwirth testified that at no time prior to his trip to London did he discuss with Alpert the meetings and discussions he had had with Burmah (II 215).

Alpert testified that the first time he heard that Geon was having discussions with Burmah was when he read about it in the newspaper (III 344).

Wholly apart from whose recollection of the conversation is the more accurate, the sum and substance of what Neuwirth said was that he was going to look over some *unidentified* persons with the thought in mind of a possible merger.* This is hardly a revelation of a material non-public fact concerning Geon.

The conclusion that Neuwirth did not disclose material non-public information concerning a possible deal between Geon and Burmah is objectively demonstrated by the evidence in the record that no material facts *were in existence* at or prior to the time Neuwirth went to England.

Bloom and Neuwirth each testified about the contacts between Geon and Burmah prior to the October trip to England (*i.e.* prior to Neuwirth's conversation with Alpert).

Bloom testified as follows. The first contact occurred in July, 1973 when a representative of Drexel, Burnham called Peter Neuwirth, Geon's president (II 20). This contact led to a meeting at Drexel, Burnham in August, 1973 which was attended by Bloom, Neuwirth, Peter Neuwirth, one or two

* While in England, Neuwirth in fact spoke to two companies, Burmah and Lucas (II 36-7). Several months later, negotiations with Burmah commenced (II 167, III 310). On the other hand, discussions with Lucas never got off the ground.

representatives of Drexel, Burnham, Max Roberts, president of Burmah Oil, U.S.A., Campbell Anderson, manager of corporate development U.S.A., and Martin Donohue from Burmah's Castrol Division (II 21-2). At the inception of the meeting, business cards were not exchanged, and the meeting lasted about one half hour during which the Burmah people asked some very general questions about the prospects for Geon's business, the future of the replacement parts business in the United States and some questions about people active in the Company (II 23-4). At the close of the meeting it was agreed that Geon would provide certain information to Burmah. However, there was no arrangement to have another meeting (II 24).

After the meeting Burmah, through Drexel, Burnham, asked for a Geon management forecast covering what Geon thought it would do in the industry, what the industry was doing generally, as well as pro forma balance sheets and income statements for five years, assuming a growth rate of 20-25 percent per year (II 26). By the third week in August, a considerable portion of this information had been transmitted to Burmah (II 27).

In late August or early September, 1973 David Gavrin of Drexel, Burnham arranged a dinner meeting at the Harvard Club (II 27-8). Concerning this meeting Bloom testified that it was a social gathering organized by Gavrin to bring the Geon and Burmah people together again (II 28). Bloom further testified that the Geon people discussed where they thought the industry was heading, as well as two new Geon programs called Ultra and Elan (II 29). The Burmah people talked about the oil business and their tanker operations (II 30).

George Neuwirth also testified about the contact with Burmah prior to his trip to England. He stated that he recalled that the July meeting at Drexel, Burnham lasted 45 minutes to an hour and that at the conclusion thereof the Burmah people did not take the Geon people to lunch (II 185). At the conclusion of the meeting there was no arrangement to meet again (II 187).

Neuwirth testified that he recalled attending the dinner meeting at the Harvard Club (II 190). However, while SEC counsel chose to ask him whether Burmah had received certain projections by the time of that meeting, counsel did not pursue with him what had transpired at that meeting (II 190-95).

The above-recounted evidence details all that had occurred prior to Neuwirth's conversation with Alpert. Even more significant than what had happened by that time is what had *not* happened. The Geon people had not yet visited Burmah or met any of Burmah's people in England, including Peter Simonis, who later turned out to be Burmah's chief negotiator (II 34-5, 38).

At this point in time, Geon did not have in its possession any concrete information concerning Burmah and its operations, other than Burmah's 1972 annual report and one or two recent *Standard & Poors* on Burmah (II 35). None of Burmah's operating people had so much as visited Geon's premises. Indeed, it was not until sometime in November that such operating people first visited Geon's premises (II 168). At that time, they toured Geon's east coast and west coast facilities (II 41-2). None of Burmah's accounting people had visited Geon's premises. The first time that they came was after the Thanksgiving weekend in 1973 (II 169). Prior to the Thanksgiving weekend Geon had not disclosed to any of its internal people or Arthur Andersen, its outside accountants, the discussions that had been going on between Geon and Burmah (II 43). After the Thanksgiving weekend for the first time Bloom asked Arthur Andersen to make its workpapers for the prior years available to Ernst & Ernst, Burmah's accountants (II 43-4).

The fact that management did not believe that the discussion with Burmah had progressed to a point of materiality is further demonstrated by the fact that Mr. Barbanell, one of Geon's directors, was not told of the Geon-Burmah discussions until the end of November, 1973 (IV 492).

At the time of Neuwirth's conversation with Alpert, no negotiations had yet taken place. It was not until a meeting at the New York Athletic Club on November 20 that Burmah

indicated an interest in establishing a date for the commencement of negotiations (II 61-2, III 244). As both Bloom and Neuwirth testified, negotiations commenced for the first time on December 17, 1973 (II 167, III 310).

The fact that meaningful contacts and discussions did not take place until late November and early December is further established by other evidence. The first time that Burmah and Geon ever discussed the subject of the price Burmah would pay, was in mid-December (III 266, 310). In addition, at the meeting of the board of directors of Geon held in November, 1973, Neuwirth announced that on December 17, his 70th birthday, he would like to relinquish his responsibilities as chief executive officer, and it was agreed that a meeting would be held on December 17 for the purpose of such an announcement (III 311). However, Mr. Neuwirth did not announce his resignation on December 17 because between the November and December board meetings it became apparent that merger negotiations were imminent (III 311).

The non-materiality of the situation that existed at the time of Neuwirth's October conversation with Alpert is further evidenced by what in fact transpired when Neuwirth later went to England. Neuwirth arrived in England on October 15 and for the first week of his stay he attended the motor show. It was not until a week after he arrived in England that he visited Burmah (III 309-10). According to Neuwirth he met with Simonis for 10 to 15 minutes before lunch (III 224). Neuwirth summed up the conversation that took place as "chit chat" and stated that no business was discussed (III 224-5). Thereafter, everyone sat down to lunch during which no business was discussed (III 227).

Thereafter, George Neuwirth, Peter Neuwirth and Frank Bloom met with Simonis, and Simonis delivered what George Neuwirth characterized as a monologue, during which Simonis said ". . . the company seems to be in good shape, we like you, you look like a nice bunch" (III 229). Neuwirth did not respond with anything salient (III 230). There were no further meetings with Burmah in England (III 230, 232). There was no timetable set for meeting again nor any discussion of further discussions (III 232).

According to Bloom the entire meeting, including lunch, lasted about 2½ hours (II 38). In characterizing the meeting Bloom testified: "The essence of the meeting was really to meet Peter Simonis and sort of look at him, see what he was like and let him take a look and see what we were like" (II 38).

Thus, it is clear that Neuwirth could not have imparted material information to Alpert because no material facts existed at or prior to the time Neuwirth and Alpert spoke. Indeed, for a period after Neuwirth's visit to Burmah in October all that could be said is that the two companies were trying to get to know each other in an effort to determine whether it would be fruitful to conduct substantive discussions in the future, and Burmah did not make an offer to Geon until two months later.

It is clear that under the relevant cases defining materiality, the state of facts concerning a prospective deal between Geon and Burmah in existence at the time of the Neuwirth-Alpert conversation in October, 1973 was not "material."

In the leading case of *Securities and Exchange Commission* v. *Texas Gulf Sulphur Co.*, 401 F.2d 833 (2d Cir. 1968), *cert. denied* 394 U.S. 976 (1969), the Court articulated the following standard:

> "In each case, then, whether facts are material within Rule 10b-5 when the facts relate to a particular event and are undisclosed by those persons who are knowledgeable thereof will depend at any given time upon a balancing of both the indicated probability that the event will occur and the anticipated magnitude of the event in light of the totality of the company activity." 401 F.2d at 849.

The standard was similarly phrased in the case of *Sonesta International Hotels Corporation* v. *Wellington Associates*, 483 F.2d 247 (2d Cir. 1973) wherein the court stated:

> "To be material a statement in a tender offer need not necessarily relate to a past or existing condition

> or event. It may refer to a prospective event, even though the event may not occur, *provided there appears to be a reasonable likelihood of its future occurrence.* Gulf & Western Industries, Inc. v. The Great Atlantic & Pacific Tea Company, Inc., *supra,* 476 F.2d at 697; Gerstle v. Gamble-Skogmo, Inc., 478 F.2d 1281, 1298 (2d Cir. 1973)." 483 F.2d at 251. (emphasis supplied)

Given the facts recounted above it cannot be said that prior to Neuwirth's trip to England in October, 1973 (*i.e.,* at the time of Neuwirth's conversation with Alpert) there was either a reasonable likelihood, or a likelihood of any measurable probability, that a transaction between Geon and Burmah would take place. Neither party had yet indicated a desire to engage in a transaction (as distinct from contacts with a view to obtaining information), and the all-important consideration of money had not even been broached, much less negotiated. The expressions of willingness to negotiate followed by discussions of money did not occur until December, 1973, almost two months later.

The case of *List* v. *Fashion Park, Inc.,* 340 F.2d 457 (2d Cir. 1965), *cert. denied* 382 U.S. 811 (1965), conclusively demonstrates the non-materiality of the facts as they existed at the time of the October Neuwirth-Alpert conversation. In that case, Lerner, a director of Fashion Park, attended a meeting of the board of directors on November 4, 1960. At that meeting a union manager reiterated his plan to withdraw 300 to 350 employees, and he urged the board to consider a sale of Fashion Park. He told the board that he knew of someone who might be interested in buying the company, *but he neither disclosed the name of his prospective purchaser nor any potential purchase terms.* The board of directors then proceeded to adopt a resolution to the effect that the company seek to negotiate a sale or merger.

After the board meeting Lerner bought shares of Fashion Park from the plaintiff. Upon these facts, this Court affirmed the District Court's finding that when Lerner pur-

chased his Fashion Park shares, he was not in possession of "material" information with respect to a possible merger or sale.

In the instant case, in October, Alpert knew less than Lerner. Alpert certainly did not know the identity of any prospective purchaser. He did not know the proposed terms of any purchase because there were none. Unlike Lerner, Alpert did not know nor could he know that either Geon or Burmah had resolved to go forward with a transaction, because neither had so resolved.

Thus, it is clear that in purchasing Geon stock in October Alpert was not in possession of any "material" facts. To the extent that the District Court held that Neuwirth violated Rule 10b-5 on the ground that Alpert purchased Geon shares in October, 1973 while in possession of material, non-public information concerning Geon provided by Neuwirth, the District Court erred.

2. *The December Purchases*

On December 19, 1973 Roy Alpert and his brothers purchased a total of 3,000 shares of Geon stock. Here again, neither the details of the transaction nor the content of the conversation between Neuwirth and Alpert preceding the transaction is in dispute. It will be demonstrated that nothing said by Neuwirth was "material"; in fact when Alpert bought Geon shares on December 19, 1973, he knew less about the Geon-Burmah negotiations than the public at large.

With regard to this purchase, the District Court found the facts as follows:

> "The Alperts" next purchase of Geon stock (3,000 shares) was made on December 19, 1973. Prior to that, Neuwirth had told Roy Alpert that he could not attend his own birthday party, planned for December 17, because he was staying in New York City and was too busy with his business commitments." (I 60a).

Alpert's testimony with respect to this purchase was as follows:

"Q. Am I correct, sir, that the extent of your knowledge about Mr. Neuwirth's whereabouts and what he was doing was that he was in New York City and that he was busy?

"A. That is correct.

"Q. He didn't tell you he was having conversations with Burmah, did he?

"A. No, I knew nothing about Burmah Oil." (III 344).

With regard to his conversations with Alpert prior to December 19, 1973, Neuwirth testified as follows:

"Q. Mr. Neuwirth, did you have discussions planned with the Burmah representatives about December 16th, 17th, 18th in New York City here, sir?

"A. December 17th is the date. December 17th is the date.

"Q. Prior to that date, sir, did you have any conversations with Mr. Roy Alpert concerning those meetings?

"A. No, I did not.

"Q. Did you have any conversation with Mr. Alpert about your participation in those meetings?

"A. I did not.

"Q. Did you have a birthday party scheduled for December 17th, sir?

"A. My birthday is on December 17th, that's why I remember the date. Unknown to me there was a party scheduled. Unknown to me. Surprise party.

"THE COURT: By whom?

"THE WITNESS: By my son. I found that out later. Usually I would spend my birthday with Mr. and Mrs. Alpert, alone. I didn't want any period.

"Q. That party was not held; is that right, sir?

"A. That party was not held. It was a working party.

"Q. Did you tell Mr. Alpert why you could not go to that party?

"A. I told him I cannot go to the party, I am busy.

"Q. Did you say what you were busy with?

"A. I didn't specify. He didn't ask me.

"Q. Did you say something to the effect that you were busy closing a deal?

"A. No, sir.

"Q. Did you tell him you were going to be staying in the city?

"A. Yes, sir.

"Q. Did you tell him why you were going to be staying in the city?

"A. Because of business commitments.

"Q. Did you tell him what those business commitments were, sir?

"A. No. No, I did not.

"Q. What did Mr. Alpert say to you when you told him that you were busy?

"A. I came back from Chicago and I stayed in the city and I had business meetings. On that day I also had the board of directors' meeting.

"Q. Well, did you talk to Mr. Alpert on the telephone or in person?

"A. Not in person. Must have been telephone.

"Q. Do you recall whether he called you, or—

"A. I think I called him from Chicago.

"Q. What did you tell him?

"A. That I'm not available the 17th.

"Q. And he didn't ask why?

"A. He didn't ask me.

"Q. You don't recall telling him then that you were busy closing a deal, or something to that effect?

"MR. STRUM: Your Honor, I object. That question has been asked and answered several times.

"THE COURT: I think it has, yes." (III 262-4).

Prior to Alpert's purchase of December 19, Geon had issued two press releases, on December 3 and December 18, respectively. The December 3 press release (SEC Exhibit 1, I 75a) recited that Geon was engaged in preliminary discussions looking to the possible acquisition of Geon by Burmah. The December 18 press release (Geon Exhibit D, I 76a) which ran on the Dow Jones broad tape *the day before* the Alpert purchase of Geon stock at issue, stated:

> "Geon Industries, Inc. (AMEX) which announced on December 2, 1973 that it was engaged in preliminary negotiations looking to the possible acquisition of Geon by a subsidiary of The Burmah Oil Company Ltd. said today that in response to inquiries that its negotiations with Burmah are continuing. Geon said that it expected to make a further announcement based upon developments in the negotiations probably by the end of the week."*

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* Inexplicably, in addressing itself to Alpert's December 19 purchase, the District Court did not mention the December 18 press release.

Thus, when Alpert purchased Geon stock on December 19, not knowing that Geon was negoiating with Burmah (III 344), he made that purchase with *less* knowledge than the public at large.

It cannot be that in stating to Alpert that he could not attend his birthday party because he was staying in New York City and was too busy with business commitments, while not mentioning Burmah at all, George Neuwirth imparted material, non-public information concerning the Geon-Burmah transaction to Alpert. Similarly, in purchasing Geon stock on December 19, in total ignorance of the fact that Neuwirth was holding negotiations with Burmah, while the public had been told in a press release on December 18 that negotiations with Burmah were continuing and that a further announcement was expected by the end of the week, it cannot be that Roy Alpert effected that purchase while in possession of material, non-public information concerning Geon.

3. The February 22 Sales

On February 22, 1974 Roy Alpert and his brothers sold approximately 8,400 shares of Geon stock. Here again, neither the details of the transaction nor the content of the conversation between Neuwirth and Alpert preceding the transaction is in dispute. It will be shown that the District Court erred in holding that Alpert's February 22 sale was predicated on material, non-public information provided by Neuwirth.

With regard to this sale, the District Court found as follows:

> "Neuwirth testified that on February 20, 1974 at their weekly dinner with their wives, he mentioned to Alpert that the next day the Geon Board of Directors was going to meet to 'rubber stamp' a contract with respect to the Burmah-Geon deal. Alpert testified that he assumed Neuwirth would call him if the deal was going through; Neuwirth testified, however, that there was no discussion of such a plan. In any event, when Alpert heard nothing from Neuwirth by Friday morning,

February 22, 1974, he and his brothers decided to sell ½ (or about 4,000 shares) of their Geon stock. After that order was executed, the Alperts sold their remaining 4,000 shares." (I 60a).

The evidence adduced at trial with respect to the conversation and the transaction is as follows:

On February 20, Neuwirth, Alpert, and their wives had their traditional Wednesday dinner together (III 281, 331). According to Alpert, Neuwirth stated that ". . . the board was meeting the following afternoon to wrap up the deal with Burmah . . ." (III 331). Neuwirth recalls that he said he was going to a board meeting "to rubber stamp an agreement" (III 282).

Neuwirth testified that he did not tell Alpert that he would call him and tell him what had happened at the board meeting, and that there was no discussion of either getting together or calling Alpert the next day (III 283).

Alpert testified that Neuwirth did not say he would call after the board meeting nor did Alpert ask him to do so (III 338-9). Alpert further testified that Neuwirth did not call him after the board meeting and the two did not speak to each other either on Thursday or Friday (III 338-9).

On Friday, February 22, 1974 Alpert and his brothers sold approximately 8,400 Geon shares (III 336). Prior to the opening, the Alperts placed an order to sell half of these shares. Later, when that order was executed, at the suggestion of their broker they sold the balance (III 335-6).

Bearing in mind that it had been announced previously that an agreement in principle had been reached for the sale of Geon's assets to Burmah for a price of $36,000,000 (SEC Exhibit 3, I 77a), it is clear that Neuwirth believed he was communicating nothing more than a previously announced *fait accompli.* The fact that the general public operated under the same belief is objectively demonstrated

by the fact that Geon stock closed at 14¾ or 14⅞ on February 21 (IV 451, 539), a price which nearly approximated the $16.70 per share that Geon shareholders could expect to receive upon consummation of the Burmah deal.

If the information given by Neuwirth to Alpert were to be characterized, it would have to be characterized as favorable to Geon's prospects. But Alpert did not *purchase* Geon shares following his conversation with Neuwirth. The significant fact is that on Friday, February 22, the Alperts were *sellers*. It is clear that Alpert did not sell on February 22 as a result of any communication by Neuwirth of unfavorable information nor indeed as a result of anything Neuwirth said or did, but rather as a result of what Alpert "assumed". Alpert testified as follows: "I assumed that it was such an important event that if he signed the papers, if the deal was going through, I assumed that he would call me and I would congratulate him and so forth."* (III 333). And Alpert really wasn't sure about his assumption because on Friday morning he and his brothers placed an order to sell only half of their stock, waiting until the later suggestion of their broker to sell the balance (III 335-6).

The plain fact is that there is neither evidence nor a finding that Neuwirth communicated any *adverse* information concerning Geon to Alpert prior to Alpert's sales of Geon stock on February 22. Consequently, as a matter of law, the District Court erred in holding that the Alperts' sales were predicated upon material non-public information supplied by Neuwirth.

Thus, it has been demonstrated that none of Alperts' transactions in Geon stock were effected on the basis of material non-public information concerning Geon imparted to him by Neuwirth. As a consequence, this Court should reverse the determination that Neuwirth violated Rule 10b-5.

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* Counsel to Neuwirth moved to strike Alpert's testimony as to what he assumed (III 333). The District Court's denial of the motion (III 333), it is submitted, was error.

Point III

The District Court's determination that Geon is liable under Rule 10b-5 should be reversed.

The District Court held that Geon was liable under Rule 10b-5 *solely* because George O. Neuwirth, its chief executive officer, had violated that rule by providing material non-public information to defendants Rauch and Roy Alpert. The District Court stated:

> "Since a corporation can only act through its officers and directors, the court finds that Geon is liable here for the violations of its chief executive officer, George Neuwirth. *See SEC* v. *Lum's, Inc.*, 365 F.Supp. 1046 (S.D.N.Y. 1973). See also, *Affiliated Ute Citizens* v. *United States*, 406 U.S. 128 (1972); *Lanza* v. *Drexel & Co.*, 479 F.2d 1277 (2d Cir. 1973). Accordingly, the SEC is entitled to the entry of a judgment granting a preliminary and final injunction against future violations of the securities laws as to defendant Geon." (I 67a-68a).

If this Court reverses the District Court's determination that George Neuwirth violated Rule 10b-5, it necessarily follows that the determination that Geon is liable must also be reversed. If this Court reverses the finding that Neuwirth provided material non-public information to Rauch, the finding that Geon is liable must be reversed, irrespective of whether this Court affirms or reverses the finding that Neuwirth provided material non-public information to Alpert.

In talking to Alpert, his friend of many years, Neuwirth was not acting in his capacity as an officer or representative of Geon. The conversations were social, not business. Thus, the October, 1973 conversation took place at the bar of their club (II 215). The February, 1974 conversation took place at a restaurant while they and their wives had dinner (III 281-2). The December, 1973 conversation was a telephone

conversation concerning Neuwirth's availability for a birthday party (III 263-4). The conversations with Alpert were not within the scope of Neuwirth's authority, real or apparent, as an officer or employee of Geon. In talking to Alpert, Neuwirth was engaging in social conversations with a friend; he was not acting for Geon.

It has been held that a corporation may be held liable for an employee's violations of Rule 10b-5 either by virtue of Section 20(a) of the Securities Exchange Act of 1934 rendering "controlling persons" liable, or by virtue of the concept that a corporation is liable for the acts of an employee acting within the scope of his authority. *Securities and Exchange Commission* v. *Management Dynamics, Inc., et al.,* C.C.H. Fed.Sec.L.Rep. ¶ 95,017 (2d Cir. March 18, 1975); *Gordon* v. *Burr,* 506 F.2d 1080 (2d Cir. 1974); *Lanza* v. *Drexel & Co.,* 479 F.2d 1277 (2d Cir. 1973).

In order to find a corporation liable for the acts of an employee by application of the "controlling persons" provision of Section 20(a) of the Securities Exchange Act of 1934, it must be found that the corporation had knowledge of the fraudulent representations or culpably participated in them in a meaningful sense. *Gordon* v. *Burr,* 506 F.2d 1080 (2d Cir. 1974); *Lanza* v. *Drexel,* 479 F.2d 1277 (2d Cir. 1973). Here there is no such finding by the District Court; nor is there any evidence in the record for the proposition that Geon had knowledge of, or in any way participated in the conversations between Neuwirth and Alpert.

The only other basis for holding a corporation responsible for the acts of an employee is upon a finding that the acts giving rise to the violation were performed by the employee acting within the scope of his authority. *SEC* v. *Management Dynamics, Inc., et al.,* CCH Fed.Sec.L.Rep. ¶ 95,017 (2d Cir. March 18, 1975). In that case, this Court sustained a determination that a brokerage firm, A.J. Carno, Inc., was liable for the acts of its employee Nadino because of the apparent authority exercised by Nadino. Nadino, in his capacity as vice president in charge of trading, and

acting in the firm's name, had submitted fictitious quotations on a certain stock in the "pink sheets".

Similarly, in *SEC* v. *Lum's, Inc.*, 365 F.Supp. 1046 (S.D.N.Y. 1973), Lum's was held liable by virtue of the acts of its chief operating officer, Melvin Chasen, in providing misleading projections to a group of analysts. Clearly, in talking to analysts Chasen was acting in his capacity as a corporate officer with the real and apparent authority of the corporation.

The instant case stands in sharp contrast. There was no finding by the District Court that Neuwirth, in speaking to Alpert, was acting in any corporate capacity or within the scope of his employment by Geon. Nor is there any evidence to that effect.

Consequently, if this Court reverses the District Court's determination that Neuwirth provided material non-public information concerning Geon to defendant Rauch, it should reverse the determination that Geon is liable, irrespective of the Court's decision with respect to whether Neuwirth provided material non-public information to Alpert.

Conclusion

For all of the reasons stated above, this Court should:

1. Affirm the District Court's dismissal of the complaint as to Bloom;

2. Vacate the injunction against Neuwirth, reverse the District Court's determination that he violated Rule 10b-5, and dismiss the complaint as to him;

3. Vacate the injunction against Geon, reverse the District Court's determination that Geon is liable as a violator of 10b-5, and dismiss the complaint as to it.

Respectfully submitted,

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UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT
NOS. 74-2614
74-2657
75-7010

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff-Appellant,

-against-

GEON INDUSTRIES, INC., et al.,
GEON INDUSTRIES, INC. and GEORGE O.
NEUWIRTH,

Defendants-Appellants,

FRANK BLOOM and EDWARDS & HANLY,

Defendants-Appellees.

AFFIDAVIT OF SERVICE

STATE OF NEW YORK)
: ss.:
COUNTY OF NEW YORK)

Patricia Anderson, being duly sworn, deposes and says that she is employed in the office of Kaye, Scholer, Fierman, Hays & Handler, the attorneys for defendant-appellee Frank Bloom and defendants-appellants Geon Industries, Inc. and George O. Neuwirth herein. That on the 8th day of May, 1975 she served two copies of the within Brief of Defendant-Appellee Frank Bloom and Defendants-Appellants Geon Industries, Inc. and George O. Neuwirth upon:

Richard E. Nathan, Esq.
Securities and Exchange Commission
Plaintiff-Appellant
500 North Capitol Street
Washington, D. C. 20549

and

Evan L. Gordon, Esq.
Delson & Gordon
Attorneys for Defendant-
Appellee Edwards & Hanly
230 Park Avenue
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by depositing two copies of the same securely enclosed in a post-paid wrapper in the post office box regularly maintained by the United States Government at 425 Park Avenue, New York, New York 10022, directed to said attorneys at the aforesaid addresses, those being the addresses designated by them for that purpose.

Patricia Anderson

Patricia Anderson

Sworn to before me this
8th day of May, 1975

Robert Thatcher

Notary Public

ROBERT THATCHER
Notary Public, State of New York
No. 9310825
Qualified in Kings County
Certificate filed in New York County
Commission Expires March 30, 1976